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February 15, 2006

AGENDA ITEM 6

TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE

I. SUBJECT: Long-Term Care 2005 Annual Valuation Report: First Reading – Valuation and Program Recommendations

II. PROGRAM: Long-Term Care

III. RECOMMENDATION: Information Only

IV. ANALYSIS and DISCUSSION:

Annual Actuarial Valuation as of June 30, 2005

The CalPERS Long-Term Care program (Program) 2005 actuarial valuation, Attachment 1, was completed by United Health Services, Inc. The valuation included a baseline valuation that incorporated assumptions based on an investment earnings rate of 7.79% (as reflected in the analysis prepared by Wilshire Consulting when the revised asset allocation was adopted by the Board in March 2005), increased expenses, revised claim costs, and higher premiums rates resulting from the 2003 premium rate increase. Further projections were included that incorporated alternative assumptions to reflect additional adverse deviations to the Program's current assumptions. The results of the baseline scenario, Scenario A(3) on page 8, show a deficit of 39.4 percent or $812.8 million. The 2004 valuation, completed by Long Term Care Group, Inc.'s (LTCG) actuaries, indicated a projected surplus of $1.3 million, or approximately 0.1% of the present value of future premiums.

The key variables that account for the deterioration of the financial position of the Program compared to the 2004 valuation are:

→ The 2005 valuation updated the detailed morbidity study initially completed in 2004 using actual Program experience through 6/10/05.

→ The 2005 valuation developed revised ultimate claims costs assumptions by credibility-weighting adjusted actual program claims costs against assumed ultimate claims costs.

→ Claims payment distributions were revised to reflect emerging experience and were developed to be consistent with current liability/reserve levels.

→ Adjustments in amounts associated with individuals already on claim have been revised.

The cumulative effect of these changes is summarized in the valuation analysis:

These revisions collectively result in a significant increase in projected future claims for the Program as compared to the 2004 valuation. Please note that if experience continues to emerge in a manner consistent with how experience has emerged to date, valuation results will continue to deteriorate.

What Are the Risks of the Long-Term Care Program?

The only true risk of the CalPERS Long-Term Care Program is that at some time there would not be sufficient funding to pay promised benefits. This can occur only if the Program's actual experience deviates from the experience assumed via the actuarial assumptions and the actual Program's experience is adverse. The key valuation assumptions wherein the Program's experience may deviate adversely are:

- Lapse rates—voluntary terminations of coverage
- Investment earnings rate—investment returns (currently 7.0%)
- Claim incidence—reflects the likelihood of going into claim
- Claim continuance, severity—reflects the probability of remaining on claim
- Mortality rates–death rate
- Expenses—administrative costs
- Investment volatility--the volatility of an investment is measured by the standard deviation of its rate of return.

In completing the 2004 valuation, LTCG actuaries were specifically asked to validate prior year assumptions, in particular focusing on claims experience and resulting costs to the Program. Due to time constraints, the 2004 valuation was not able to include the necessary detailed analysis but did identify potential difficulties and recommended further detailed analysis of the Program's actual claims experience and incorporation of that experience as credibility increased. While the 2004 valuation indicated a small surplus, the overall fiscal condition of the program was subject to considerable risk particularly as claims experience and morbidity/mortality were adjusted to better reflect actual Program experience.

The 2004 valuation did provide projections for adverse deviations to the Program's assumptions. Specifically, two items were identified that had a significant impact on the estimated valuation and were consistent with items identified by the Board's consulting auditors, Deloitte and Touche, in their commentary on the Long-Term Care Program valuation. The two changes were to extend the projection period to 50 years from the 40 years used in prior valuations and to reduce the morbidity/mortality improvement by 50% to better reflect actual Program experience. The impact of these two additional items influence the claims experience and reduced the estimated surplus by 9.3% ($210.6M) and 11.2% ($253.6M) respectively. When United Health Services was engaged to complete the 2005 valuation these issues were highlighted for consideration as they continue to impact the long term financial viability of the Program.

Changes Made for 2005 Application Period

As part of the Board discussions of the 2004 valuation, staff made additional recommendations, and the Board approved, changes to Program assumptions as a step towards solidifying the Program's financial status. Specifically, the Board approved the following Program changes effective with the 2005 application period:

- Raise financial targets – Increase the positive side of the static surplus test to at least 20% of the present value of premiums.
- Assumptions – Add margins that are more conservative to address a wider range of possible adverse financial scenarios.
- Reduce investment volatility – Periodically review the portion of Program assets comprised of equities. Also, if Program surplus and market conditions allow, modify the equity portions opportunistically (bearing in mind such reduction in volatility risk could decrease long term investment reward).
- Modify the product mix – The Program needed to change the product mix to remain competitive in the marketplace while reducing the long term liabilities for the Program. The changes included the following items:
  - Adopt the benefit trigger of two (2) Activities of Daily Living (ADL) for all benefits. Based on preliminary pricing assumptions, this will have no premium impact, simplifies marketing materials and makes the Program's products more competitive.
  - Increase Home Health Care (HHC) benefit to 70% of nursing home benefit amount. This addresses the gap between home health care expenses and nursing home benefits, develops strong market appeal, simplifies marketing materials, and makes Program products more competitive. With this change, both Assisted Living Facility (ALF) and HHC benefits will be expressed as 70% of the daily nursing home benefit.
  - Add a Contingent Nonforfeiture provision to all plans. This makes the Program plans more competitive with no impact on premiums.
  - Eliminate the $110 Daily Benefit Amount (DBA) plan option. This would set the minimum benefit level at $130 DBA which is 70% of the 2005 Average Private Pay Rate of $180. DBA options for 2005 will be: $130, $150, $170, $200, and $250.
  - Add a Total Coverage Amount of 6 years times the DBA. This option makes coverage more affordable for those who want "deep" coverage but cannot afford lifetime coverage. It provides an option between three (3) years and a lifetime, which adds more flexibility to the Program. This option has good market appeal based on survey findings and is good for the risk pool by moving some participation away from lifetime and into finite durations. It makes the Program products more competitive and reduces premiums from those of lifetime coverage by over 18%.

Any new products should be appropriately priced. Please note that the 2005 valuation does not include a specific valuation of 2005 new business for the following reasons:

- New business rates were just re-priced for 2005
- New business constitutes a relatively small portion of the total block.
- There were significant issues associated with in force business issued through 6/30/05 so focus was on those policies.

The 2005 premiums rates were, however, reviewed for reasonableness.

- Review underwriting standards – With ten years of claims experience it is appropriate to review the Program's underwriting standards and modify as necessary.

Recommendations

The 2005 valuation report includes preliminary mitigation actions, including a 20 percent premium increase on all policies in effect on June 30, 2005. The Long-Term Care Advisory Committee met on February 6, 2006 and will provide staff with an assessment of possible mitigation actions. Staff will provide the Board with recommended mitigation actions at the March Health Benefits Committee meeting.

V. STRATEGIC PLAN:

This item is not a specific product of the Strategic Plan. It is brought to the Committee because of a request by the Board to report annually.

VI. RESULTS/COSTS:

The number of members who applied for the CalPERS Long-Term Care Program clearly indicates the Board's responsiveness to satisfying members' demands and needs for financial security associated with long-term care coverage.

Staff is available to answer questions.

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Office of Health Plan Administration

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Terri Westbrook
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Attachment